Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 15 (Revised)

'Ind AS Transition Facilitation Group' (ITFG) of Ind AS Implementation Group has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders. Ind AS Transition Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications[1] on April 4, 2018:

At its 19th meeting held on May 11, 2019, ITFG considered a comment received by it on the following paragraph of response to Issue 7.

"The deposits which are contractually repayable on demand will be recognised at the transaction price on initial recognition similar to the initial recognition of demand deposit liabilities given under Ind AS 113 paragraph 47."

As per the comment, the above paragraph seems to give an impression that where a financial asset contains a demand feature (e.g., the holder has a contractual right to demand payment before stated contractual maturity), the exercise of such right as per contractual terms is presumed in determining the fair value of the financial asset without regard to expected timing of exercise of the said contractual right.

ITFG noted that it is clear from Ind AS 113 that the determination of fair value of a financial asset with a demand feature is based on expected timing of exercise of contractual rights relating to the demand feature. This is unlike a financial liability with a demand feature in which case the determination of fair value is made as if the counterparty would exercise its right to demand payment immediately on such right becoming exercisable as per the terms of the contract.

In order to avoid any potential misinterpretation of the paragraph under reference, ITFG decided to amend the paragraph under reference.

In accordance with the above, response to Issue 7 is amended and the revised ITFG Clarification Bulletin 15 is as follows:

Issue 1: Company PQR Ltd is required to comply with Ind AS from financial year 2017-18. It had issued Foreign Currency Convertible Bonds (FCCB) at the rate of 6% interest rate on April 26, 2013 to a foreign Investor (bondholder). The tenure

[1] Clarifications given or views expressed by the Ind AS Transition Facilitation Group (ITFG) represent the views of the ITFG and are not necessarily the views of the Ind AS Implementation Group or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of this Bulletin is April 4, 2018. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the ITFG. The clarifications given are only for the accounting purpose. The commercial substance of the transaction and other legal and regulatory aspects has not been considered and may have to be evaluated on case to case basis.

of the FCCB is five years and one day. As per the terms and conditions, the FCCB would be converted into equity on April 26, 2018 at the option of the holder On the settlement day, the Company will issue the fixed number of shares, e.g. 100,000 shares. Interest on the FCCB is payable on a half yearly basis, which has been paid on regular basis.

To comply with the relevant RBI norms, the FCCB issued by the company were at the maximum permissible interest rate on the date of issuance, say, 6%. However, based on the guidance under Ind AS company has assessed that the applicable rate after considering, currency, time period, credit status and without conversion option for borrowing would have been, assuming 7.5%.

What should be the rate of interest at which the liability portion of the FCCB be discounted to determine the present value of financial liability at initial recognition?

Response: As per paragraph *28* of Ind AS 32*, Financial Instruments, Presentation, "The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15."*

Paragraph 29 *inter-alia* states that, *An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity).*

As per the requirements of Ind AS 32, FCCB is a compound financial instrument (fixed for fixed met as per Ind AS requirement) and the issuer of the compound financial instruments is required to split the instrument into two components i.e. one as liability and other as equity component on initial recognition. It may be noted that in accordance with paragraph 11(b) (ii) of Ind AS 32, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument with the exercise price is fixed in any currency.

Paragraph AG31 of Ind AS 32 states as follows:

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the

issuer of such a financial instrument to present the liability component and the equity component separately in the balance sheet, as follows:

(a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

(b) The equity instrument is an embedded option to convert the liability into equity of the issuer. This option has value on initial recognition even when it is out of the money.

In accordance with the above, the recognition and measurement requirements of Ind AS 32 require the issuer to account the compound financial instruments in the following manner:

- The liability portion of the FCCB would be measured at the fair value by determining the net present value of all contractually determined future cash flows under the instrument, discounted at the market rate of interest prevailing at the time of issue. The discount rate for this should be comparable to the instrument for aspects, such as, currency, time period, credit status and cash flows, but without the conversion option.
- The equity component is the residual amount after deducting the liability component from the fair value of the compound instrument.

Accordingly, in the given case, the company should discount the future cash flows at 7.5% to determine the financial liability for initial recognition. Difference between fair value of financial liability and transaction value would be accounted as equity as per the guidance under Ind AS.

It may be noted that the response is based on the limited facts and circumstances and is only for accounting purpose. The commercial substance of the transaction and other regulatory aspects such as the requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

Issue 2: ABC Limited has issued non-cumulative compulsorily redeemable preference shares. Redemption is in cash after 10 years, dividend @ 6%. The market rate of interest is @ 4%. Preference shares have been issued to an unrelated party. During the term of the instrument, dividends are payable at the discretion of ABC Ltd. The instrument is a compound financial instrument as per the requirements of Ind AS 32 *Financial Instruments, Presentation*.

What will be the accounting treatment of the preference shares and dividends which are at the discretion of ABC Ltd. and the same have not yet been declared by ABC Ltd.

Response: Paragraphs 31 and AG 37 of Ind AS 32 state as follows:

> *31 Ind AS 109 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore,* ***when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component****. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.*
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> *AG37 The following example illustrates the application of paragraph 35 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date.* ***Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss.*** *A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (eg commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense."*

In accordance with the above, the non-cumulative redeemable preference shares are compound financial instruments since the payment of dividend to preference shareholders is with the discretion of the issuer, i.e. ABC Ltd. Accordingly, on initial recognition, the fair value of the instrument will be bifurcated into liability and equity component. The fair value of the liability component on initial recognition is determined as the present value of the eventual redemption amount discounted at the market rate of return. The equity component is the residual amount, i.e. the difference between the present value of the liability component and fair value of the instrument as a whole.

Furthermore, any discretionary dividends will be recognised when they are actually declared and paid and will relate to the equity component and accordingly, are recognised as a distribution of profit or loss

It may be noted that the response is based on the limited facts and circumstances and is only for accounting purpose. The commercial substance of the transaction and other regulatory aspects such as the requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

Issue 3: MNO Ltd. has an incentive receivable in the form of sales tax refundable from the government, under a scheme of government on complying with the certain stipulated conditions. Whether such incentives receivable from government will fall under the definition of financial instruments under Ind AS 109 considering that there is no formal one to one contractual agreement between government and the company?

Response: As per Ind AS 32 *Financial Instruments, Presentation*, *A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.*

A financial asset is any asset that is:

- *(a)* *cash;*
- *(b)* *an equity instrument of another entity;*
- *(c)* *a contractual right:*
  - *(i)* *to receive cash or another financial asset from another entity; or*
  - *(ii)* ...
- *(d)* ....

Paragraph 3.1.1 of Ind AS 109, *Financial Instruments*, states as follows:

An entity shall recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1.1–4.1.5 and measure it in accordance with paragraphs 5.1.1–5.1.3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 4.2.1 and 4.2.2 and measure it in accordance with paragraph 5.1.1."

As per the above, a financial instrument arises as a result of contractual obligation between the parties.

Paragraph 13 of Ind AS 32 states that, *"In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the*

agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing."

The above paragraph clarifies that contract need not be in writing only and may take various forms. In India, government does give incentives in the form of taxation benefits etc. to promote industry or for some other reasons as the case may be. Although under such schemes, there may not be a one to one agreement between the entity and the government as to the rights and obligations but there is an understanding between the government and the potential applicant/company that on complying the stipulated conditions attached to the scheme, the entity will be granted benefits of the scheme.

If in the given case, the entity has complied with the conditions attached to the scheme then it rightfully becomes entitled to the incentives attached to the scheme. Accordingly, such incentive receivable will fall under the definition of financial instruments and will be accounted for as a financial asset per Ind AS 109.

Issue 4: XYZ Limited is a company having net worth less than INR 250 crores as on 31 March 2017. What is the status of applicability of Ind AS for the company in the following scenarios:

(a) the company was in the process of listing as at the beginning of the year (i.e. 1st April 2017) and the company ultimately gets listed as at the end of the year (March 2018);

(b) the company is listed at the beginning of the year and during the year it gets de-listed;

(c) the process of listing began during the year, for e.g. in the month of May 2017 and the company ultimately gets listed as at the end of the year i.e. March 2018. Will there be any difference if the company gets listed in April, 2018. i.e. it was in process of listing as at the year end.

(d) the company issued listed debentures in the month of May 2017. However, in the month of January 2018, the debentures got de-listed.

Response: Rule 4 (1) of the Companies (Indian Accounting Standards) Rules 2015 read with Companies (Indian Accounting Standards) (Amendment) Rules, 2016 *inter-alia* states as follows:

"(i)...

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) of clause (ii) of subrule (1) and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) of clause (ii) of sub- rule (1) and sub-clause (b) of clause (ii) of sub- rule (1) as the case may be; and

(iii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;

(b) companies other than those covered in clause (ii) of sub- rule (1) and sub-clause (a) of clause (iii) of sub-rule (1), that is, unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.

(c) holding, subsidiary, joint venture or associate companies of companies covered under sub-clause (a) of clause (iii) of sub- rule (1) and sub-clause (b) of clause (iii) of sub- rule (1), as the case may be:"

(a) In the given case, since the company began the process of listing as at the beginning of the year but had net worth less than INR 250 crores, it shall be required to comply with Ind AS from the financial year 2017-18. Accordingly, XYZ Limited shall prepare Ind AS financial statements for the financial year 2017-18.

(b) In the given case, since the company is listed at the beginning of the year it shall be required to comply with Ind AS from the same year irrespective of the fact that the company gets de-listed as at the end of the year. Accordingly, XYZ Limited shall prepare Ind AS financial statements for the financial year 2017-18.

(c) In the given case, although the company was neither listed as at the beginning of the period nor it began the process of listing as at the beginning of the year, but it began the process of listing during the year and ultimately got listed as at the end of the year then it shall be required to comply with Ind AS from the same year in which it began the process of listing. Furthermore, in case the company gets listed during the year say from November 2017, then it will be required to provide Ind AS financial statements for the quarter ending December 2017 and consequently for the year ending March 2018.

Moreover, in the given fact pattern, if the company was in the process as at the year-end, then also it will be required to comply with Ind AS and provide financial statements as per Ind AS for the year ending March 2018.

(d) In the given case, as at the beginning of the reporting period, the company was not listed. However, it issued listed debentures during the year, i.e., in the month of May 2017 which got de-listed in the month of January 2018. Accordingly, the company has neither the status of a listed entity/or in the process of listing at the beginning of the year as well nor at the end of the year. Hence, it will not be required to comply with Ind AS.

Issue 5: The Company is a registered stock-broker recognised by the Securities and Exchange Board of India (SEBI). The net worth of the Company as on 31st March 2015 is INR 500 crores. As per the Ind AS Rules, it falls under the definition of NBFC roadmap and accordingly, is required to apply Ind AS from 1st April 2018 onwards.

In the month of July 2016, the company applied for terminating its membership to the exchange. It was awaiting clearance from SEBI as of June 2017. It received clearance from the Board in the month of August 2017 accepting their termination. The company also have debt listed securities.

Whether the company should have prepared Ind AS financial statements as a Phase 1 non-NBFC corporate entity as of 31 March 2017 given it has applied for termination of membership with the exchange in the month of July 2016?

Response: Companies (Indian Accounting Standards) (Amendments) Rules, 2016, defines NBFC as follows:

"Non-Banking Financial Company" means a Non-Banking Financial Company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 and includes Housing Finance Companies, Merchant Banking companies, Micro Finance Companies, Mutual Benefit Companies, Venture Capital Fund Companies, Stock Broker or Sub-Broker Companies, Nidhi Companies, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies."

Further Rule 4(1) (iv) of the said rules lays down the roadmap for applicability of Ind AS as follows:

"Notwithstanding the requirement of clause (i) to (iii), Non-Banking Financial Companies (NBFCs) shall comply with the Indian Accounting Standards (Ind AS) in preparation of their financial statements and audit respectively, in the following manner, namely :-

(a) The following NBFCs shall company with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter-

(A) NBFCs having net worth of rupees five hundred crores or more;

(B) holding, subsidiary, joint venture or associate companies of companies covered under item (A), other than those already covered under clauses (i), (ii) and (iii) of sub-rule (1) of rule 4.

(b) The following NBFCs shall comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st march, 2019, or thereafter-

(A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchanges in India or outside India and having net worth less than rupees five hundred crore;

(B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and

(C) holding, subsidiary, joint venture or associate companies of companies covered under item (A) or item (B) of sub-clause (b), other than those already covered in clauses (i), (ii) and (iii) of sub-rule (1) or item (B) of sub-clause (a) of clause (iv)."

In the given case, the company being a stock-broker was falling under the definition of NBFC as per the above rules and hence as per its net worth was required to comply with Ind AS from 1st April, 2018 onwards.

However, in the given case, in July 2016 the company had applied for termination of its membership as a stock-broker. Accordingly, it needs to be evaluated that whether the company is carrying on the activities of an NBFC or not.

It is also pertinent to note the following clarification issued by ITFG Clarification Bulletin 13 (Issue 4):

In view of the above, it is pertinent to note that the above definition covers a company which is carrying on the activity of Non-Banking Financial Company. The definition of NBFC is given under the RBI Act, 1934. Hence ***the company which is carrying on the activity of NBFC but not registered with RBI will also be subject to the roadmap for the applicability of Ind AS as applicable to any other NBFC.*** *However, the requirements with regard to registration, eligibility of a company to operate as NBFC (pending registration) etc. are governed by the Reserve Bank of India Act, 1934 and Rules laid down thereon and should be evaluated by the entity based on its own facts and circumstances separately.*

In accordance with the above, if the company was carrying on the activities of an NBFC during the period it was awaiting approval from RBI, then it shall be required to comply with Ind AS as per the roadmap applicable to NBFC. However, if it ceases to carry on the activities of NBFC then the roadmap as applicable to non- NBFC companies should have been followed based on its net worth.

In the given case, assuming that the company was not carrying on the activities of NBFC from July 16 onwards as it has applied for termination of its membership in July 2016, then as per its net worth it should have complied with Ind AS from July 2016 onwards.

Issue 6: Company X is the wholly-owned subsidiary of Company Y and |Promoters' hold 49.95% in Company Y as on 31st March 2015. Company Y merges with Company X on 1st April 2015 and amalgamation was in the nature of purchase as per AS 14, *Accounting for Amalgamations*. Company X is required to adopt Ind AS from financial year 2017-18. The date of transition to Ind AS is April 1, 2016. Under Ind AS, Company X has not opted for the exemption under paragraph C1 of Ind AS 101, *First-time Adoption of Indian Accounting Standards*, of not applying Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS).

Whether on the date of transition to Ind AS the company is required to apply requirements of Appendix C to Ind AS 103, *Business combinations of entities under common control* in the given case?

Response: Paragraph C1 of Ind AS 101 states that, *"A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind ASs). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date."*

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2010, it shall restate all business combinations that occurred between 30 June 2010 and the date of transition to Ind ASs, and it shall also apply Ind AS 110 from 30 June 2010.

In the given case, since the company has not taken exemption under paragraph C1 of not restating past business combinations accordingly, the company will be required to retrospectively apply the requirements of Ind AS 103.

Appendix C to Ind AS 103 deals with accounting for business combinations of entities or businesses under common control. Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

It is also pertinent to note that an investor with less than majority voting rights can also have control over the investee under Ind AS 110 (eg. through contractual arrangements, de facto control, potential voting rights etc. Accordingly, the company needs to evaluate whether they are under common control.

In the given case, assuming that the entities are under common control before and after the amalgamation and the company has not opted exemption under Ind AS 101 then the requirements of Appendix C to Ind AS 103 shall be applied retrospectively.

Issue 7: Whether Interest free refundable security deposits (such as rent deposits paid to lessor etc.) given by an entity are required to be discounted as per the principles of Ind AS? If yes, at what rate should these be discounted?

Response: As per Ind AS 32 *Financial Instruments: Presentation*, *"A financial asset is any asset that is:*

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d)........"

In accordance with the above, refundable security deposits given by an entity is a financial instrument and should be classified as a financial asset in accordance with Ind AS 109.

As per paragraph 5.1.1 of Ind AS 109 *Financial Instruments*, *At initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.*

Paragraph B5.1.1 further states that, *"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS113). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset."*

B5.1.2A The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Ind AS 113). If an entity determines that the fair value at

initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:

(a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

In accordance with the above, where the effect of time value of money is material, refundable security deposits should be discounted and should be shown at their present value at the time of its initial recognition. With regard to the rate at which these should be discounted then entity needs to evaluate based on its own facts and circumstances taking into account the above guidance. Further, whether the effect of the time value of money is material or not should be determined on an overall consideration of total cash flows, etc. The difference between the transaction price and fair value as determined above should be accounted in accordance with Paragraphs B 5.1.1 and B 5.1.2A. For example, in case of an interest free rent deposit paid to a lessor in respect of a non-cancellable operating lease arrangement, the above difference may be deferred as prepaid rent to be recognised as an expense over the underlying lease term in accordance with Ind AS 17.

The determination of fair value of a deposit which is contractually repayable on demand is made by considering the expected timing of exercise of demand.

Issue 8: XYZ Limited is a government company and is required to comply with Ind AS. It is in the business of development of smart city. For development of smart city, XYZ Ltd. allots its land to customer on 99 years of lease. The customer is required to pay lease premium at the time of execution of lease deed and lease rent on annual basis over a period of 99 years. The lease premium amount is the market value of land and lease rent is nominal amount say Re. 1 per square meter per year. The lease premium is non-refundable.

As per the lease terms, on completion of 99 years, the lease is renewable at mutual consent of lessor and lessee.

How would income in respect of lease premium collected by the XYZ Limited (which is the market value of land and is not refundable) at the time of execution

of lease deed be recognised as per Ind AS. For subsequent years, only nominal lease rent is collected.

Response: Paragraph 6 of Ind AS 18, *Revenue* scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 17, *Leases* would be applicable for revenue arising from leasing agreements.

Recognition of income in respect of lease would depend on its classification as per Ind AS 17, *Leases*.

It may be noted that ITFG Clarification Bulletin 7 (Issue 5) deals with the broad principles to be kept in mind while classifying lease as operating or finance lease. It also states that it requires exercise of judgement based on evaluation of facts and circumstances in each case, while considering the indicators given in Ind AS 17.

If it is concluded that lease is an operating lease, then it will be accounted for in accordance with paragraphs 49 and 50 of Ind AS 17, *Leases*, as given below:

49 Lessors shall present assets subject to operating leases in their balance sheet according to the nature of the asset.

50 Lease income from operating leases (excluding amounts for services such as insurance and maintenance) shall be recognised in income on a straight-line basis over the lease term, unless either:

(a) another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis; or

(b) the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.

If it is concluded that lease is a finance lease then in accordance with paragraphs 36 and 39 of Ind AS 17, lessors shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. 'The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

In the given case, the long lease term may be an indication that the lease is classified as a finance lease subject to the consideration of other relevant facts and circumstances. If it is so classified, the lessor should carry out the accounting for finance lease as explained above and there will be no receivable, since the entire amount is received upfront.

Issue 9: A Company has investment in a partnership firm and it has established that it has control over the firm as per the requirements of Ind AS 110, *Consolidated Financial Statements*. Accordingly, as per Ind AS, the company is required to consolidate the firm as its subsidiary and its financial statement is required to be in compliance with Ind AS. There are amounts outstanding towards retired partners' capitals, which are repayable by the partnership firm on demand. What would be the accounting treatment of these outstanding retired partners' capital balances? Whether these are required to be discounted?

Response: In the given case, since the company has assessed and established control over the partnership firm as per Ind AS 110, accordingly, it will be required to consolidate the partnership firm as per the requirements of Ind AS. Though Ind AS would not be applicable to the partnership firm nevertheless its financial statements to be consolidated by the company is required to be in compliance with Ind AS.

In the given case, since the amounts outstanding towards retired partners' capitals can be demanded by those retired partners anytime and it meets the definition of a financial liability under Ind AS 32(i.e. it is firm's contractual obligation to deliver cash or another financial asset), accordingly, the same shall be measured at its fair value.

Paragraph 47 of Ind AS 113 states that 'the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.'

Accordingly, in the given case based on the facts provided these amounts are considered as repayable on demand at any time, and therefore, no discounting would be required on initial recognition and subsequent measurement.

Issue 10: Company B is a listed entity covered in phase II of Ind AS roadmap. Company A is an unlisted entity having net worth less than INR 250 crores and holding Company of Company B. Company D is an unlisted entity and holds 25% in company B (i.e, Company D is an investor company of Company B)and has net worth less than INR 250 crores. Company C is a fellow subsidiary of company B i.e. subsidiary of the holding company A. Whether Ind AS is applicable to Company C and Company D?

Response: As per the roadmap for applicability of Ind AS, holding, subsidiary, joint venture or associate companies of companies which meet the specified criteria are required to comply with the Indian Accounting Standards (Ind AS).

In the given case, since Company B meets the criteria for Ind AS adoption, its holding company would also be required to adopt Ind AS from the same date. Accordingly, Ind AS will be applicable to Company A by virtue of Ind AS being applicable to its subsidiary i.e. Company B in the given case.

With regard to Ind AS applicability for company C, it may be noted that Ind AS applies to holding, subsidiary, joint venture and associate companies of the companies which

meet the net worth/listing criteria. This requirement does not extend to another fellow subsidiary of a holding company which is required to adopt Ind AS because of its holding company relationship with a subsidiary meeting the net worth/listing criteria. Holding company will be required to prepare separate and consolidated financial statements mandatorily under Ind AS, if one of its subsidiaries meets the specified criteria and therefore, such subsidiaries may be required by the holding company to furnish financial statements as per Ind AS for the purpose of preparing Holding company's consolidated Ind AS financial statements. Such fellow subsidiaries may, however, voluntarily opt to prepare their financial statements as per Ind AS.

Hence, in the given case, Company C is not mandatorily required to adopt Ind AS for its statutory reporting. Further, company C may apply Ind AS voluntarily for its statutory reporting.

With regard to Ind AS applicability for Company D, it may be noted that Company D is just an investor company and does not qualify as a holding company of Company B. Company D is not required to comply with Ind AS by virtue of Company B falling under the threshold of Ind AS applicability (unless it otherwise falls under the road map for applicability of Ind AS, as a consequence of other conditions specified therein). Furthermore, for consolidation purposes, Company B will be required to provide financial statement data prepared in accordance with Companies (Accounting Standards) Rules, 2006 for the purpose of preparation of consolidated financial statements of Company D as per these rules.

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